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April 22, 2008

**AGENDA ITEM 5b**

**TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE**

- I. SUBJECT:** Health Maintenance Organization Financial Reserves Update
- II. PROGRAM:** Health Benefits
- III. RECOMMENDATION:** Information Only

**IV. INTRODUCTION:**

At the March 2008 Health Benefits Committee (HBC) meeting Blue Shield of California (Blue Shield) and Kaiser Health Plan (Kaiser) provided the HBC information regarding their financial reserves. This report is to provide the CalPERS Board of Administration (Board) responses to various questions posed to Blue Shield and Kaiser.

**V. ANALYSIS:**

Blue Shield of California

In addition to providing an update on Blue Shield's financial reserves, Blue Shield agreed to provide the HBC with follow-up information on how financial reserves are invested. Blue Shield consistently uses industry standard methods to set and manage reserves. Based on historical comparisons of actual claims run-out to booked reserves, Blue Shield's reserving for CalPERS has been highly accurate. Independent reviews by external auditors have confirmed that Blue Shield's reserving is reasonable and accurate. Even if reserving is off in either direction, it has, at most, a minor and temporary effect on pricing due to the roll-over feature in the Blue Shield contract.

Overall Blue Shield remains financially strong as shown by ratings from the credit rating agencies and its Risk Based Capital (RBC) level. Adequate reserves assure that the rates approved by the Board for the 2007 plan year were sufficient to cover the cost of healthcare and administrative costs.

At the March 2008 HBC, the following issues/questions were raised that required further follow-up and responses by Blue Shield staff:

1. "What is Blue Shield's target investment return on reserves?"
2. "How does Blue Shield arrive at its current asset allocation of 70 percent in cash and fixed income and 30 percent equities?"
3. "If Blue Shield's returns on investment portfolio are higher than expected, does that get rebated back to the CalPERS or factored into CalPERS's next year's rates or does Blue Shield just adjust its portfolio composition to a more conservative portfolio composition so Blue Shield doesn't generate excess returns?"
4. "How does Blue Shield's reserves, in both level and accuracy perspectives, translate into CalPERS's rates? How does it work and is there a relationship between reserve level, margin, and rates?"

See Attachment I for Blue Shield's response.

#### Kaiser Health Plan

Kaiser ended 2007 with an operating margin of 4.6 percent. The operating margin is less than 5 cents on the dollar and in line with the organization's goal to maintain a 4 percent to 6 percent margin. Kaiser's performance demonstrates financial health and stability. Kaiser is on track to meet their long-term financial plan and managing their cost structure, which will help them meet their goal of reducing the rate of premium increases.

Kaiser invests in a variety of funds, including Fixed Income, U.S. Equities, International Equities, and Private Equity, and had strong returns in 2007.

Maintaining a positive financial position helps Kaiser provide sustained fiscal stability for CalPERS and other customers, and ensures they can provide high-quality, affordable health care well into the future.

At the March 2008 HBC, the following issues/questions were raised that required further follow-up and responses by Kaiser staff:

1. "As it relates to the financing of capital investments, how much does Kaiser pay out of annual premiums? How much does Kaiser cover through debt, the issuance of debt and how is it spread out over the life of the asset?"

See Attachment II for Kaiser's response.

**VI. STRATEGIC PLAN:**

This directly relates to Goal X: Develop and administer quality, sustainable health benefit programs that are responsive to and valued by enrollees and employers.

**VII. RESULTS/COSTS:**

There is no cost associated with this item.

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Attachments